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Taxable Income and the Tax Board

By ROBERT H. MONTGOMERY

In many respects, the Board of Tax Appeals has rendered valuable and intelligent service. In some cases there has been a rather hard-to-understand disregard of one of the fundamentals of net taxable income, assuming that the federal law imposes a tax solely on realized income.

This disregard appears to arise from a failure to understand the accrual system of bookkeeping. The Board reiterates its adherence to the accrual system when it upholds the Commissioner in his findings regarding constructive income and various other accruals, some of which accord with good accounting principles and some of which do not.

When applied to accrued expenses and losses, the Board takes a stricter position and frequently disallows accruals which are proper and necessary under all systems of good business and sound accounting. The most flagrant example is that of estimated costs and expenses, which are not precisely determinable at the end of accounting periods, but which must be taken into account or else the results for such periods are distorted and inaccurate.

The Board supports its position by stating that the law permits the deduction only of "realized" costs and expenses, thus disregarding the very specific provisions of the law which call for the use of the accrual system and methods of accounting which reflect the true net income of taxpayers.

The Courts sometimes support the Tax Board, and sometimes refuse to support it. My reason for this article is to urge adherence on the part of accountants to good accounting principles and strongly urge that they should not be discouraged by apparent disregard of these principles by the Tax Board.

In tax matters the Courts often sustain the Commissioner and the Tax Board, even though the taxes in litigation have been imposed upon gross rather than upon net income, and upon unrealized rather than upon realized income. Frequently tax cases which involve complicated accounts and somewhat involved accounting principles are presented to the Courts by lawyers who have never grasped the first elements of accounting. Accountants themselves, in presenting cases to the Tax Board, do not always make as good a presentation as they should.

The foregoing was intended to be a short foreword to a short discussion of a recent case—*Hewitt Realty Company v. Commissioner,* U. S. C. C. A. 2nd, decided April 8, 1935.

A lessee erected a building on leased land. The lessor failed to include as income any part of the value of the building. The Commissioner and the Board added some $10,000 to the les-

sor's income. On appeal the Circuit Court reversed the Board. In a minority opinion Judge Chase said that the amount added to income was incorrect, but that, in view of the regulations, etc., some amount should have been deemed to have been income. He reviewed all of the regulations back to 1917, which make interesting reading.

In the majority opinion Judge Hand said, in referring to the benefit to a lessor: "It is a far cry to say that it is income at any time before sale."

As to the force of regulations he said:

". . . this is not merely a question of the meaning of a statute, but of what can normally be taxed under the Sixteenth Amendment, and the reenactment of the income tax law has little or no effect upon that. It was possible at the outset to say that capital gains and losses were not income at all; they are not popularly so regarded, and in Great Britain for example they are not taxed as such. In this country we have decided otherwise, and that step taken, we might have gone further and said that any increase in value was income; that would have been awkward in administration—it would involve an annual appraisal of all the taxpayer's goods—but it would have been rational. The Supreme Court held otherwise; the gain must be 'realized'; *Eisner v. Macomber*, 252 U. S. 189; *North American Oil Co. v. Burnet*, 286 U. S. 417, *Lucas v. North Texas Co.*, 281 U. S. 11. Just when it in fact is 'realized' is not always easy to say. We concede that in a situation like that at bar a lessor need not receive money to be taxable; if improvements to land be portable—detachable machinery for example, which he can take off and sell as separate chattels—he receives income either when the lease is made, or when the term ends; for present purposes we need not say which. On the other hand if the lease requires the lessee to drain the land, or set out shade trees, or pave it, or grade it, or build a golf course, or a race-track on it, we can see no difference between the resulting increase in its value and that arising from the growth of the surrounding neighborhood, or the increase in value of a share of stock. The question as we view it is whether the value received is embodied in something separately disposable, or whether it is so merged in the land as to become financially a part of it, something which, though it increases its value, has no value of its own when torn away. It does not help towards the solution of this that the lessee may be able to deduct the cost of the building from his own income. Expense to him has no relation to the lessor's income.

"Therefore in our judgment if a building when removed be worthless, save as bricks, iron and mortar, it becomes income only when the land is sold, and then only in so far as it increases the 'amount realized' at that time—the minuend in the equation of gain. This answers every fiscal necessity far more directly and simply than any other formula. While the term lasts, the lessor gets nothing which benefits him but the rent; when it ends, he gets land for which he can get a higher rent—that is, if the building is neither outworn, nor outmoded. On all rents he must pay a tax. If he sells at any time, pending the term or after it ends, the building will increase his gains; and his taxes in proportion. But a power to sell is not the same as a sale. It might have been thought to be, but it was not; at least it has not been in circumstances precisely alike in all relevant respects. The doctrine may have its exceptions, but if so, we can see no reason to import one here. The alternative requires a factitious scaffolding; the value of the reversion is appraised by adding the present value of the building and depreciating it to the end of the term; the balance is then distributed ratably over its whole span. In the case at bar another factor must be included, the possibility of the lessee's renewal. All this is not necessary to the collection of taxes upon such income as is actually received in the ordinary sense; nor does it accord with the principle which for most purposes anyway is to be treated as constitutional dogma. There may well be other considerations proper when the lessee's deductions are concerned, but as to the lessor, he ought not to be taxed till he sells."

Off and on for many years I have criticized the tendency to tax unrealized income. I know that some of my

friends get tired of my persistence. I hope that Judge Hand's opinion will be given careful consideration.

As I cannot count on any one referring to what I have said in past years, I will make the job easy and quote from *Income Tax Procedure*, 1929, page 620:

> "Article 48 does not attempt to impute income where there is none. It merely requires that the value of the improvement *subject to the lease* shall be reported as income. If it required a lessor to report the value of the building, there would in many cases be no money with which to pay the tax. What the value is of the improvements subject to the lease depends entirely upon the circumstances of each case, but the author knows of few such transactions which would result in taxable income. There must be realization before there can be taxable income."

In my opinion, accountants are charged with notice that in all cases when authorities differ regarding the interpretation of tax laws, clients should be protected until the doubtful points are decided by the United States Supreme Court. It is reasonable to assume that those who have protected their clients in the lessor-owner cases will now be able to collect refunds.

The foregoing applies to many other doubtful points which have not yet been settled by the Supreme Court. Clients are justified in relying on tax advisors to protect them and in due course collect the refunds.

The Financial Statement and Its Analysis from the Accountant's Standpoint *

By Walter B. Gibson

I don't believe that a credit man should necessarily be an accountant or have intimate technical knowledge of accounting. You should know *something* about it—yes, principally the weak spots; the things to watch out for in the statements submitted to you.

We have just been through a lot of pretty tough years. Remember Will Rogers, in his daily paragraph a year or so ago, said that after thinking it all over, he had decided that the old timers who used to insist that the world was flat weren't so dumb after all?

Kinds of Protection

Because of the depression all of us have had brought to our minds a lot of things that we didn't fully appreciate before in regard to credits. One of them is that analysis of statements by a credit grantor should provide two sorts of protection. First, protection to the seller against loss of his merchandise and his money; second, protection of the would-be purchaser against himself. If any one thing has been borne in on public accountants in the last several years, it is the tendency of people in general and business men in particular to fool themselves; to avoid the facing of facts. At least nine tenths of the corrections which we public accountants make on financial statements have to do with honest errors or misjudgment on the part of business executives who have prepared or have directed the preparation of the statements in the first place. Less than one tenth have to do with intentional misstatements or real deception.

Honest Misstatements

There are many kinds of honest misstatements in the reports from customers which are submitted to you for credit purposes. Perhaps the most common is in regard to the profit possibilities of the business which is asking you for a credit line. Don't rely on the balance sheet alone! Get the facts on the profits and the trend of profits.

A few years ago, at the height of things around here, a new finance concern was organized with a carefully worked out plan of operations. It had abundant capital and apparently considerable credit. Accountants were asked to take the plan of operation and from it to set up the books of account preparatory to starting business. Analysis of the plan indicated that the proposed business couldn't carry itself, that there would be an inevitable loss from the first day, and the accountants so advised their clients and refused the engagement. Nevertheless, the business went ahead, made considerable of a splurge for a short time, and then crashed and crashed hard. Repercussions of the crash have been in your newspapers within the past year, and yet it is possible that the promoters honestly believed the scheme would work.

*A talk given at the Educational Forum of the Los Angeles Credit Men's Association on March 7, 1935.

Special Circumstances

In New York last year, the head of a large statistical company told me of a statement for the first six months of 1934 put out by a prominent textile manufacturing company. This statement showed profits for the six months of several hundred thousand dollars, large sales, and a big profit over and above manufacturing cost. On its operating showing the company appeared to be a proper candidate for large scale credit.

But my friend proceeded to tell me that early in 1934 the company in question had made heavy disposals of its raw material on a rising market and at a huge profit over cost, but further that it had used up, in those six months, either by sale or in its manufacturing processes, all of its low-priced inventory acquired previously. That was where its profit came from! It was a fact that the company could not, by any stretch of the imagination, replace its raw materials at the current market prices, manufacture its line of product, and dispose of it at a profit. The large gain in the first six months of 1934 was a flash in the pan, due to special circumstances, and a vendor extending credit to it was putting his goods and his money into a losing venture.

Make your applicant for credit *prove* his profit potentialities by affording you access to his detailed operating statements and, even more important, his budgets of operations for the future.

Balance Sheet

Turn from the operating statement to the balance sheet. My analysis and yours must prevent our being fooled and the customer himself being misled in many easy ways. Just run over this partial list of possibilities with me:

1. Improper grouping of accounts on the balance sheet, with items crowded in under the wrong headings so that the real condition isn't at all apparent.
2. Accounts receivable overvalued, due to the natural optimism of a man regarding his own business, or receivables in a potentially dangerous situation because they are all with one or two big customers who may not be in any too good condition themselves, i. e., eggs in one basket.
3. Overvaluation of inventories. Again because of this natural optimism and frequently because of failure to realize what "balance" means in an inventory. The total amount reasonable and in order but the inventory made up three quarters of slow-moving, relatively unsalable merchandise and all the sales coming out of a small section of the stock, churning over and over.
4. Failure to recognize income tax liabilities either on past transactions or deals in the making—honest enough, but misleading.
5. The omission of commitments either to sell or to buy something or other at some time in the future. Vitally important, but easily overlooked.

Illustration

Here's an actual example, and there are many like it.

A corporation which found itself in financial difficulties had been submitting its balance sheet to creditors in, I am convinced, absolute good faith, showing current assets of, roughly, $208,000 and current liabilities of $143,000. An examination resulted in reducing the current assets by $111,000 to $97,000 while the liabilities were increased $8,000.

This correction wasn't quite so bad as it sounds, however, as $80,000 of it was reducing the value of securi-

ties whose market value the principal creditors undoubtedly knew. But the remainder was cut out of assets which creditors merely suspected might be overstated. Inventory of some $60,000 required writing down of $17,000 representing price drops or actual shortage of material, and left some $43,000 of actual stock on hand at cost. Even this $43,000 left in the balance sheet needed the qualifying explanation that $25,000 of it represented very slow-moving stock with a scrap value of only $3,000 or $4,000.

Accounts receivable took a $10,000 reduction to provide for the loss of accounts hopeless of collection but still carried as assets, and another $1,000 because the detailed accounts did not total up to the amount in the general books. It was found that a $4,500 loan from a personal friend of the president was buried in the accounts receivable, and that had to be transferred to current liabilities.

Investment securities, so-called, included $6,000 of the company's own bonds carried at par and $4,000 of worthless securities besides the main block that required the $80,000 write-down.

Current taxes had been omitted from the balance sheet, and $3,000 had to be set up. The net result was a reduction of almost $120,000 in working capital shown in the accounts, from $65,000 to a minus $53,000, and bringing the current ratios from an apparent 1½ to 1 down to an actual ⅔ to 1.

Operating results were similarly distorted by the over-valuation of inventories and failure to provide for bad debts and further by the omission of depreciation (averaging $12,000 a year) from expenses.

And so on and so on—all honest mistakes, perhaps, and all of them perfectly familiar to you and none of them ever (or hardly ever) getting past you.

Window Dressing

Sometimes you, as credit grantor, and we, as accountants, are confronted with what is known as "window dressing." To handle this requires some severity with the perpetrator and a little more of the detective instinct on the part of the credit grantor. You have to be like the smart workman who was playing cards with a fellow worker during the noon hour and said "Mike, what was that last card I dealt you?" "Sure and it was a spade." "I thought so, I saw you spit on your hands when you picked it up."

As credit grantors, you *have* to catch this window dressing. You don't like it, but there is something inherent in us all that makes us want to put our best side forward in a good light and conceal our defects. For instance, this practice perhaps not as common now as it used to be, of holding the cash receipt book and the sales book open for a week or so after the end of a year to get in some extra payments on accounts receivable and some extra sales, but closing down tight on the incoming invoices on the last day of the month. Sure it makes a better-looking statement, but it is a type of window dressing.

Temporary End of Year Adjustments

One of the favorite ways of dressing up a statement is the clearing up of personal balances owed by officers or stockholders of the company over the statement date. The usual method is of course for the president of the

company to draw his check for $50,000 (if that is the amount he owes) on December 31 and have it recorded on the books as clearing his account. On January 2 the company reloans him $50,000 (or perhaps $60,000) and the incoming check meets the outgoing one in the personal account of the president, and all is well. It is a fact that at the close of business on the last day of the fiscal period the loan was nominally paid off. Naturally, you as credit grantors, and we as accountants, are disposed nowadays to look behind the nominal fact.

Anticipated Profits

Then there is the taking up of anticipated profits—a construction job partly done with all or too much profit taken up; a finance company showing all its discounts as earnings even when the paper runs for another six months or a year. Some concerns even include in this month's profits the discounts they expect to get for paying their bills on time next month. It is interesting to note that very seldom do those same people think of deducting from profits the discounts that *their* customers will take when they pay their bills.

Recording a profit on merchandise or a commodity of some sort that the company still has, but on which the price has risen since purchase—that's not a profit, it's a potential profit! I can think of many examples but this one in particular comes to my mind, where a large concern with a dairy herd which it operated and also sold down from time to time, made a nice $60,000 profit one December by buying several hundred head of cattle at $15 a head and valuing them in inventory a week or so later at about $40. No, they didn't sell them, they just valued them. "All our cows are worth $40."

Sales Under Repurchase Agreements

Sales under repurchase agreements are particularly hard to catch in statement analysis. The sales may be of merchandise which the company manufactures, unloaded at a nice profit on a customer with a commitment to take it back at the end of thirty days or so. Or it may be accounts receivable or securities owned by a company sold to an accommodating friend for cash with an agreement to repurchase within a specified time. I can recall one balance sheet where $350,000 had been received for securities unloaded in this manner to the eventual distress of the company itself and the creditors who had swallowed the misrepresentation.

There is really only one thing to do with window dressing. I don't think very much of it, even if nobody is fooled by it, and I believe it is essential, for the establishment of a proper relationship between you and your customer, that the ornamental nothings be stripped from the asset side of the statement and the consequential omissions be put back on the liability side so that the two of you meet and discuss on a frank "I'm not kidding you and you're not kidding me" basis. That relationship is sometimes difficult to arrive at; sometimes it seems to involve a choice between taking a chance on a slightly deceptive customer as he is or losing him entirely. It's a hard choice, in fact, it's a dilemma. I remember a doggerel about a dilemma that I heard many years ago

back in New England during a coal strike.

> Now is it slicker on the whole
> To hide my liquor 'neath my coal?
> Or on the whole now, is it slicker
> To hide my coal beneath my liquor?

I doubt to-night if this is either the time or place to go into the question of financial analyses for the detection of calculated fraud and misrepresentation in credit statements. We all know of numerous examples, but let's save them for another evening.

I am nearly through, and what have I said? What does it all amount to? Is there anything constructive to be learned from all this? Well, that depends. For one thing, I believe that those of us who have been on the firing line during the depression are coming out of it with less faith in people than we had before. Don't misunderstand me; I do not mean that we have all become cynics, but that Lesson Number 1 has been that we should not rely on what people tell us about themselves and their business affairs, without trying to prove it in every possible way. We *don't do* a man a favor when we accept him or his financial statements at face value without such test. We may be merely aiding and abetting his downfall.

Federal Tax Handbook, 1934-1935

Review from American Bar Association Journal, March, 1935

The 1934-1935 edition of Montgomery's Federal Tax Handbook, like its long list of predecessors, is one of the most useful volumes that the lawyer, accountant, or business man can have at hand for the variety of federal tax problems that increase with each year. Busy tax practitioners, as well as those who need solution of such problems only occasionally, will find it a very satisfactory ready reference book. These volumes, moreover, issued since 1917 in new editions as made necessary by the new taxing acts, have been notable for their highly personal character and the salty comment with which the author has sprinkled subjects otherwise somewhat tasteless. Many pages yield asides, advice, caution, praise for sound rulings or decisions, scorn for bad ones, philosophy, or prophecy. Instead of a mere statement that the Board of Tax Appeals in a certain case computed depreciation in a certain manner, the author quotes the language with relish, observing that it "is remarkable as much for its wisdom as for its literary flavor." Or he says, "the duty of the Treasury and the Board is becoming increasingly illogical with respect to what constitutes the accrual method of accounting." By examples he proves his point. There is almost no subject within the scope of the book that is not enriched by the author's experience, vision, and ingenious mind.

This edition is a competent successor to previous editions. Decisions and rulings added since the last edition are included, and the volume contains adequate discussions of the changes made

(*Concluded on page 14*)

Auditors' Reports

Based on Chapter 29 of

MONTGOMERY'S AUDITING THEORY AND PRACTICE

*(Fifth Edition)**

What shall it benefit an auditor if he performs the highest grade of professional work and is unable to present his results in a form acceptable and comprehensible to his client?

In both the textual parts of reports and in formal schedules the auditor should aim to express his findings so clearly that he cannot possibly be misunderstood. Clients are glad to get reports written in an interesting manner and with a pleasing style. Then, too, the points presented will probably leave a more permanent impression; constructive suggestions will no doubt be more favorably accepted and lastingly remembered.

Interim Reports

Sometimes interim reports are helpful by serving not only to apprise the client of progress and to give him early information, but also to provide material portions of the final report draft and permit advance discussion of its content. Considerable time is saved also in the preparation of the report by accumulating on memorandum sheets, during the course of the audit, all observations and suggestions by the men in charge of each section of the work. This data is then readily available as material when the report is to be constructed.

Where Should the Report be Written?

The pleasantest and most ineffective place in which to write a report is the auditor's own office. This conclusion comes from the author's personal experience and that of the majority of practitioners. There are those who disagree and contend that a better report can be written there, where it is quiet and work is uninterrupted by the client or his staff.

Notwithstanding these arguments, the author believes that at least the major part of the report should be written in the client's office. This permits the auditor to discuss with the client or his representatives questions which may not have been settled.

Something More Than Figures Wanted in a Report

It is unusual for an able accountant to conduct an audit and have nothing of value to report to his client other than his opinion of the correctness of the financial statements. The auditor gains access to records which the ordinary executive does not see and has opportunity to observe the staff under conditions which do not exist when the boss is around. This does not imply that the auditor should report trivial matters which will make the staff hostile without being of real benefit to the client. A report should be a constructive document, helpful to the client's staff as well as to the client.

Bankers are also desirous of supplemental comments other than statistical, as they are obliged to vouch for the

* Published December, 1934 (The Ronald Press Company, New York).

personnel of an organization as well as for its financial structure.

What Not to Report

It is not wise to report unimportant errors, etc. The inclusion of detailed schedules, as of trade debtors and creditors, except where requested, has been discontinued in current practice. This, however, may be necessary in reports in which special circumstances govern, such as changes in partnership. In general, the auditor should omit from his report detailed information covered by routine internal reports by the client's own organization.

Introduction to Report

In order to establish the status of the auditor it is customary at the beginning of a report to make some reference to the fact that the auditor was duly authorized to make the report. This reference is frequently specific, such as "under the authorization of your board" or "as directed in your letter of (date)."

The introduction may also include a statement of what is included in the report, such as the nature of the comments and the form of the supporting schedules; or this may be conveniently covered by reference to an index of comments and schedules. The introduction should also indicate briefly the scope of the work and the sort of examination which has been made in the light of the purposes for which it was authorized.

If work is omitted which should have been performed, a carefully worded report which points out what work was done cannot be used by the auditor to escape liability for omissions. Limitations on the scope of examination which have been authorized should, of course, be clearly set forth in the report. In certain types of engagements, it is appropriate to indicate in some detail the extent of verification of the various records and the several classes of accounts therein. The requirements of certain state bank commissioners and of the credit departments of some banking institutions, for instance, provide for specific comment by the auditor on the extent of his verification of the various accounts.

Requirements of Customary Audit Reports

When financial statements are not designed for publication, the most satisfactory report on the audit of the average industrial concern would consist of the following comments and statements:

Comments:
- Results of operations and variations in profit.
- Financial position and application of funds.
- Other comments and criticisms based on data examined.
- Constructive comments on other matters.
- Scope of examination.

Statements:
- Balance sheet supported by detailed schedules, whenever necessary or of practical use.
- Income statements with supporting schedules, if desirable.
- Surplus statement.
- Special schedules.

Comments Based on Data Examined

To insure the reading of this report by the maximum number of those interested, the auditor should see that matters of primary interest are presented at the outset of the report. It is frequently helpful to prepare a brief first section consisting of several pages packed to the brim with points which

should interest the heads of the client's organization. This portion will close with reference to the more detailed comments which follow, giving the reader an opportunity to decide whether or not he cares to go into the second section.

Comments on Results of Operations †

A comparative income account for the periods involved is frequently used as a starting point for comment as to results of operations. The figures thus presented may then be discussed in a clear and simple manner so as to explain fully their meaning and effect upon the financial status of the enterprise.

Comments on Financial Position and Application of Funds †

Although a comparative balance sheet indicates the increases and decreases in assets, liabilities, and net worth during a given period, it does not explain how the additional funds were received and used during that time. With the aid of a comparative balance sheet and certain additional information, a statement of application of funds, when properly prepared, will show the changes in financial condition, the sources of additional funds, and how these funds were used.

Unusual Conditions Relating to Cash

The presence of an unwarranted number of vouchers in the working cash funds or of unauthorized employee advances and loans might call for comment in the report if not for adjustment of the statement. Particularly large balances carried on deposit with small banks or small balances which might be consolidated to avoid service charges may be brought to the client's attention in the report. The segregation of balances in closed banks should be mentioned.

† Illustrative forms of statements setting forth these principles may be found on pages 678 to 681 of *Auditing Theory and Practice.*

Accounts Receivable

Reports submitted for credit purposes should contain analyses of accounts receivable by age, indicating at the same time the status of the accounts and adequacy of allowances for losses on collection. The amount of each classification collected up to the writing of the report, together with a statement of the average period of collection in general, i e., the turnover of the accounts receivable, is also information desired by credit men. Unusual credit terms, involving large amounts of receivables, and exceptionally large percentages of output sold to individual customers may be proper additional subjects for comment.

Basis of Valuation

The basis of valuation of each major group of assets should be disclosed, and when different from the conventional basis should be explained.‡ The mere statement that inventories are valued "at cost" or "at the lower of cost or market" may be insufficient in these days of involved factory accounting systems. When assets have been revalued by appraisal, the facts concerning such revaluation should be set forth. The bases of valuation of intangible assets are also usually of interest to the reader of an audit report.

Inventory Turnover

An important measure of the effi-

‡ The investment bankers code of fair competition provides that the annual balance sheets of issuing companies shall disclose the basis used to compute the figures at which the principal asset items are carried thereon.

ciency of a merchandising business is the calculation of the number of times the inventory is turned over during the year. Substantial profits can be made on a narrow margin if the normal investment in inventory can be sold a sufficient number of times during the year.

Changes in Capital Structure

In the auditor's first report, or in a report addressed to a new management, it is generally useful to include an outline of the capital structure of the client company setting forth a brief history of the security issues and a description of the more important provisions of the several classes of securities. When there have been changes during the year in the corporate structure due to reorganizations, exchange of securities, stock dividends, and the like, a clear summary of such changes and their effect is usually included in the auditor's report.

Bond and Preferred Stock Indenture Provisions

The auditor's program should include verification that all provisions of the indentures under which the client company's securities were issued have been satisfactorily met during the year under review. These include sinking fund provisions, requirements as to asset ratios, dividend restrictions, preferences, and the like. The auditor's report should deal with such features of his investigation and include particular reference to any violations of the provisions and restrictions.

Comparisons, Analyses, and Ratios

To make their reports interesting and informative, auditors frequently include statistical and comparative information regarding past year's earnings, operating details, and the like. In cases where some of the figures presented have not been personally verified, specific qualification to that effect should be made.

Below are given examples of ratios and turnover figures which can often be embodied in an audit report to advantage.

1. Return earned on average capital invested in business during the period.
2. Turnover of capital employed.
3. Turnover of inventories.
4. Turnover of accounts receivable.
5. Ratio of fixed property investment to sales.
6. Ratio of current assets to current liabilities.
7. Percentages of costs and expenses to sales.
8. Ratio of current assets to total assets.
9. Profits from various departments, products and other sources to amounts of investments therein.
10. Ratio of earnings to interest requirements on bond issue.
11. Ratio of earnings to dividend requirements on preferred stock outstanding.
12. Comparisons of client's results of operations with those of the industry as a whole, if the latter are available by the use of external statistical records.

Reconciliation of Figures in Audit Report and Books

Unless the auditor knows that all changes which affect surplus have been or will be taken on the books, he should furnish the client adjusting journal entries or a reconciliation of surplus, preferably as a supplement to the audit report, in order that the explanation of differences will be a matter of record.

Adjustments may be required to correct errors discovered by the auditor

or to modify asset valuations or both. Whether or not adjustments should be entered on the books depends upon the circumstances of each case.

Adjustments that Affect the Client's Books. If the books have not been finally closed until after the auditor has completed his work, all adjustments that he recommends should be entered, in order that the statements to which he certifies may actually agree with the books. If, however, the books have been closed before he makes his examination, some auditors feel that adjustments which will automatically be corrected in the following period, need not be transferred to the books. The auditor may insist upon reflecting the adjustments in his statements, in order that the balance sheet will show correctly the concern's financial condition at the close of the year and that the statement of earnings will include all elements of income and expense applicable to the period then ended. To be sure, if they are not placed on the books they must be taken into consideration in stating the net income of the subsequent period.

Adjustments designed to correct errors that otherwise will remain on the books indefinitely should be entered in any event. If the books have been closed, to the extent that such adjustments affect net income, they should be carried to surplus; in relation to adjustments to balance sheet items, no problem of this nature arises.

The auditor is not usually expected to make the entries on the client's records; he will have performed his duty when he has given to the client the entries needed to bring the client's accounts into agreement with his statements. Should the client refuse to enter the adjustments, and the auditor is convinced that their omission will vitally affect the financial statements, he has no course but to give effect to them in the balance sheet, or to qualify his certificate.

Adjustments Not for the Client's Records. Some adjustments which the auditor is required to give effect to in his statements need not be entered on the books; the working papers, however, should contain the journal entries to accomplish the necessary transfers. The accounts receivable ledger, for example, is likely to contain credit as well as debit balances, while the accounts payable ledger may contain debit as well as credit balances. In both instances the debit balances indicate assets; the credit balances, liabilities.

English and Canadian Practice. The Companies' Act of both England and Canada specify that the auditor's certificate must state, among other things, that the balance sheet is "as shown by the books of the company."

Comments and Suggestions Regarding Systems and Records

As previously stated, there is a growing tendency among business men to expect from the auditor more than the mere verification of financial position and operating results even when the latter is the primary purpose of the investigation. An expression of opinion regarding the adequacy of the client's accounting records may properly be a part of the auditor's report and when given is often most illuminating. Through his work on the records he should be in a position to suggest improvements which make for better control over transactions, provide more

useful information for the management, or result in simplification of methods and consequent economies. The auditor should not only consider the adequacy of the records accounting for past financial transactions but also the advisability of introducing or extending budgetary methods which have the aim of facilitating more careful planning and co-ordinating future transactions.

Frequently the auditor will have opportunity to offer constructive advice to his client with respect to forms of records which are to be kept, methods of preparing statistical reports, and the form of their presentation. An extensive revision of a client's system of records should not be attempted, however, unless he has had the necessary specialized training for this type of work, but he can, nevertheless, take advantage of many opportunities for suggesting specific improvements in the records and reports to executives.

The comments or suggestions, other than those which directly affect the balance sheet or income account, should usually be rendered separately, since it is impossible to foresee the uses to which audit reports may be put.

Auditor's Certificate as Part of Report

When a report contains numerous comments, it is not necessary to insert a formal audit certificate in the text. It is, however, a matter of taste. Some auditors begin their reports with formal certificates, but in most cases these statements look out of place. In other cases certificates are inserted before the financial schedules or on the face of the balance sheet. When a certified balance sheet is submitted separately, the fact that the statement is certified and the form of certificate may be conveniently shown in the report in this way.

Use of Graphic Charts in Audit Report

The information disclosed by statistical reports and tabulations often can be presented more effectively by means of graphic charts and at times such charts, properly and correctly prepared, are advantageously incorporated into auditors' reports. In order to prepare accurate charts of good appearance and at low cost, it may be found profitable to use the photostatic process, particularly when there are a number of copies needed for the report.

Federal Tax Handbook, 1934-1935

(*Continued from page 8*)

necessary by the 1934 Act. Nor is this volume any exception to the rule that the Montgomery prefaces are read by almost everyone familiar with the taxing acts with delight, respect, and profit. Since the death of the lamented and loved Dr. Thomas Adams, no one else in the tax field has used a sharp-pointed pen so well to puncture what the author calls "the unintelligent mutterings of the ignorant and uninformed." If it should be necessary to delegate the work on the many future editions to others, the author's many friends would vote that he, and he alone, should always write the prefaces, and the longer the better.

FOREST D. SIEFKIN.

Recent Changes in New York State Taxes

By John A. Marik

(New York Office)

The ever mounting cost of unemployment relief during the depression, coupled with a decline in the productivity of income and other types of taxes, has caused a search for new sources of revenue through taxation and increases in rates of existing taxes. The new taxes or increased rates for old taxes may be christened as "temporary" or "emergency," but having once come into being, such taxes, like "Topsy," just grow naturally to maturity and permanency.

The new tax on unincorporated business enacted by New York State in February, 1935, increases of the rates of business corporation franchise tax and personal income tax, and the new tax on payrolls to provide unemployment insurance, record the steady advance of the ever rising tide of taxation.

New Tax on Unincorporated Business

A new Article, 16A of the New York Tax Law, imposes a temporary emergency tax of 4 per cent on net income (above a specific exemption of $5,000) derived within the State from "unincorporated business."

Unincorporated Business: This term is defined as "any trade, business or occupation conducted or engaged in by any individual, statutory or common law trust, estate, partnership, or limited or special partnership, society, association, executor, administrator, receiver, trustee, liquidator, referee, assignee or by any other entity or fiduciary." Enterprises subject to the corporation franchise tax on ordinary business corporations, real estate, holding, public utility, insurance, bank and financial corporations are excluded.

The practice of law, medicine, dentistry and architecture are expressly exempted for the reason that under existing law it is not possible to organize such an enterprise in a way that will subject it to the business corporation franchise tax. In any case in which more than 80 per cent of the gross income is derived from personal services actually rendered by the individual or partners in the practice of any other profession and in which capital is not a material income-producing factor, the enterprise as such is expressly excluded from the tax.

One of the reasons advanced in justification of the tax on net income of unincorporated business has been that ordinary business corporations are subject to the franchise tax measured by 4½ per cent (6 per cent on net income for the calendar year 1935) of net income, while unincorporated business escaped such a levy on net income, and that the new tax will tend to equalize competitive conditions between similar kinds of business whether or not carried on in corporate form.

Application of the Law: The new tax applies only to the calendar year 1935 or a fiscal year ending in the calendar year 1936. It is in addition to the State income tax payable by the proprietor, trustee, or the members of a partnership, on the net income

of such unincorporated business. Accordingly, unincorporated businesses are brought in line with business conducted by corporations since dividends received by resident individuals from an incorporated business have always been subject to the State personal income tax, even though the corporation may have paid a franchise tax based on its net income.

Basic Date: For the determination of gain or loss from the sale or other disposition of property, the basic date is January 1, 1935. This means that the cost or inventory value applies to property acquired on or after that date. If the property was acquired before that date, gain or loss is computed by deducting from the proceeds of sale, the cost or fair market value as of the basic date, whichever is higher in the case of a gain, or whichever is lower in the case of a loss. If either cost or fair market value as of the basic date is higher than the proceeds of sale, no taxable profit arises; if either is lower, no deductible loss results.

Gross Income and Deductions: In computing net income of unincorporated business the terms "gross income" and "deductions from gross income" have substantially the same meaning as when used for State personal income tax purposes. Income from dividends is taxable as a part of net income in the same manner as in the case of franchise taxes applicable to the net income of ordinary business corporations.

However, a special provision authorizes deduction of a reasonable amount on account of personal services of a member of an unincorporated business if such person is actively engaged in the business. The amount of this deduction is to be determined by the Tax Commission, subject to the limitation that the aggregate of such deductions cannot be more than 20 per cent of the gross income less the ordinary and necessary expenses of doing business, but in no case more than $5,000 per member.

Allocation of Net Income: If the books of an enterprise doing business both within and without the State reflect the proportion of income derived from within the State, the total income must be returned together with the part apportioned to the State, with a statement setting forth the basis of apportionment. Otherwise, the allocation of net income must be made according to the statutory formula, which requires the ascertainment of the ratios assignable within the State to the total amounts of the following factors within and without the State: (1) Value of tangible personalty and realty averaged on the basis of the amounts at the beginning and end of the reporting year; (2) Wages, salaries and other personal compensation paid to employees; (3) Gross receipts from sales or service charges. The allocating percentage is determined by calculating the average of the three ratios.

Profits or losses from the sale or other disposition of realty located in the State and rental income therefrom are to be allocated entirely within the State.

Returns: If the gross income of the business is more than $10,000, or if there be net taxable income under this law, a return is required to be filed with the State Tax Commission between April 15 and May 15, 1936.

If there be no taxable net income where the gross income is less than $10,000, a return will be due upon special request only. For a fiscal year ending in the calendar year 1936, the return must be filed not later than 4½ months after the close of the fiscal year. The Commission has authority to grant reasonable extensions of time for filing.

Payment of Tax: The tax is payable at the time of filing return. If an extension of time for filing the return is granted, interest accrues at the rate of 6 per cent per annum from May 15, 1936, or in the case of fiscal year corporations from the due date for the return.

Administrative Procedure: For the purpose of administration and enforcement, the procedure laid down for the personal income tax upon individuals is to be followed.

Personal Income Tax

For any taxable year beginning on or after October 1, 1934, the normal tax on personal incomes has been increased under the following new scale of graduated rates:

Net Taxable Income Over Personal Exemptions	Rates
First $1,000	2 per cent
Next 2,000	3 " "
" 2,000	4 " "
" 2,000	5 " "
" 2,000	6 " "
Over 9,000	7 " "

The foregoing rates contrast with the following rates for returns filed for the years 1932, 1933 and 1934:

First $10,000	2 per cent
Next 40,000	4 " "
Over 50,000	6 " "

Prior to 1932 the rates were just one half those last mentioned.

The *minimum normal tax* of 2 per cent, which was first required to be paid on the income of 1934, if such amount was more than the tax computed at the graduated rates on net income, is continued. It is computed on ordinary net income with personal exemptions allowed, but with gains and losses from sales or exchanges of capital assets eliminated.

The additional temporary *emergency* tax of 1 per cent is also continued for the year 1936, based on 1935 income and for fiscal years for which a return is due in 1936. This tax was imposed upon personal incomes for the years 1933 and 1934. The same base is used as in the computation of the minimum normal tax. The major purpose of the emergency tax is to impose a burden of 1 per cent on all personal income realized in the State, even though the entire income may have been wiped out through capital losses.

As a deduction for worthless securities and abandoned business capital assets is not a loss from the sale or exchange of property, such deduction is permissible in computing the minimum normal tax and the emergency tax.

Payment of Taxes: The normal income tax on calendar year returns may be paid in full on or before April 15, or at the taxpayer's option, in three instalments: one-half on April 15; one quarter on June 15; and one quarter on October 15. Formerly the second instalment of the tax was payable three months after the return was due. A fiscal year return must be filed on or before the 15th day of the fourth month following the close of the year and one half of the normal tax is due at that time, one fourth

within two months and one fourth within six months after the return is due.

As heretofore, the 1 per cent emergency tax must be paid in full at the time the return is filed.

Information Returns

Effective for the year beginning January 1, 1935, all returns of information of payments of salaries, wages, interest, rent, etc., and of tax withheld at source in the case of nonresidents, are required to be filed on February 15 instead of April 15, as heretofore. This provision follows the Federal practice. February 15 is also the new date for payment to the State of the tax withheld at the new rates applicable to 1935 and subsequent years.

Partnership

The term "partnership" is now defined to include a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation or venture is carried on and which is not a trust, estate or corporation. This definition follows substantially that in the Federal tax law. The term "partner" includes a member of such an organization. Requirements and treatment of partnership returns apply to these types of organizations for any taxable year beginning on and after January 1, 1934.

Other Significant Changes

Certain important changes have been incorporated in the law, to conform the State practice to Federal practice. These changes apply to any taxable year beginning on or after January 1, 1935, as follows:

In a decedent's return, all items of income and deductions accrued to the date of death are to be included in his final return ending on such date, even though the deceased had theretofore reported on the cash basis.

Amounts received as annuities are to be included in gross income, except the excess received in the reporting year over an amount equal to 3 per cent of the aggregate premiums paid, until the amounts excluded equal the aggregate premiums paid.

Losses from wagering transactions are allowed only to the extent of the gains from such transactions. This particular provision applies to all taxable years beginning on and after January 1, 1934.

Corporation Franchise Tax

In the case of ordinary business corporations subject to the corporation franchise tax under Article 9A of the New York Tax Law, the former tax rate of 4½ per cent has been increased to 6 per cent for the year beginning November 1, 1936, only. This will not affect those corporations taxed on an alternative basis other than on net income. No change has been made in the one mill rate on capital stock.

The old rate of 4½ per cent remains applicable to the income of 1934 which is to be reported on Form 3 IT to be filed in 1935 as a basis for the assessment of tax for the year beginning November 1, 1935. The accrual date for franchise tax is November 1 and the tax applies to the ensuing tax year.

Returns: Every ordinary business corporation which is subject to the tax under Article 9A, and every such foreign corporation which has officers, agents or representatives within the State, is required to file its corpora-

tion franchise tax return on Form 3 IT with the State Tax Commission by May 15, 1936, and annually thereafter. The report to be filed in 1935 will be due as heretofore on July 1. A corporation with a fiscal year ending March 31, April 30, May 31 or June 30 will continue to file its report within thirty days after the filing of its Federal income tax return.

Foreign Corporation: There is an important innovation in the law, which should not be overlooked by foreign corporations not doing business in the State in the ordinary and generally accepted meaning of the term. The new provision declares that for the purpose of the State corporation franchise tax payable by ordinary business corporations, the holding of realty in the State by a foreign corporation is to be deemed doing business therein.

This provision does not affect those foreign corporations which are wholly engaged in the purchase, sale or holding of title to realty and which under existing law will be, as in the past, subject to the State real estate corporation franchise tax under Article 9 of the New York Tax Law, for the privilege of exercising their corporate franchises in the State.

Interest Accruing to Stockholders: In computing "entire net income" constituting the total statutory tax base, the definition of that term has been modified in such a way as to exclude any deduction "for interest on indebtedness to stockholders or shareholders or members of their immediate families, except interest on moneys borrowed for ordinary expenses of the corporation." However, this provision is expressly inapplicable to investment trusts, corporate or noncorporate, whose principal business consists of holding, buying and selling for their own account, the securities of other corporations.

It is not yet clear how this limitation of interest deductions will be applied in practice, but it is apparent that deductions for interest to stockholders or members of their immediate families upon outstanding debenture bonds, certificates of indebtedness, certificates of beneficial interest or other indebtedness, the proceeds of which have been used for construction or to acquire assets, will be disallowed.

Business in the Custody of the Law: Under federal permissive legislation (Public Act No. 392—73rd Congress), all receivers authorized to conduct a business were made subject to all State and local taxes applicable to such business.

The object of this legislation was to annul the effect of the decision in *Howe v. Atlantic, Pacific and Gulf Oil Co.* (4 Fed. Supp. 162), by plugging up a legal hole which was causing loss of States' revenues and incidentally to eliminate the unfair, competitive tax advantage which businesses in receivership might have had over solvent business.

The New York legislature has taken advantage of the foregoing enabling Act and has incorporated an express provision in the business corporation franchise tax law so that any receiver, liquidator, referee, trustee, assignee or other fiduciary or officer or agent appointed *by any court,* who conducts the business of any corporation is taxable in the same manner and to the same extent as if the business were conducted by the agents or officers of the corporation.

Allocation: Any corporation, which maintains a permanent store, ware-

house, factory or other regular place of business (excepting a statutory office) outside of the State of New York, is entitled for the purpose of the franchise tax based upon net income, to an allocation of the total tax. This allocation is determined by a segregation of certain assets within and without the State. In the preparation of the return on Form 3 IT, the assets which are required to be segregated at actual values, according to sources within and without the State are tangible personalty and realty, accounts receivable arising from sales or services connected with the operation of the corporation's business, and stock investments in other corporations.

Heretofore, when the reported segregation of assets was unsatisfactory to the Commission due to an allegation on its part that the segregation did not properly reflect the corporate activity or business transacted, the Tax Commission claimed authority under a section of the law which purported to vest the Commission with power, under the so-called "equitable adjustment provision," to use some other method to adjust the tax.

Considerable doubt had always existed in the minds of many tax practitioners as to the validity of this provision. In at least two cases decided by the New York Court of Appeals, the inference had been drawn that this provision was vague for lack of a statement of a definite workable rule or of a suitable rule of procedure. In general, every rule of law, as a matter of sound policy, to be a good and wise law, should be express and certain and this fundamental applies with special emphasis to taxing statutes.

Additional Statutory Formula for Allocation: A serious attempt has now been made by the legislature to remedy this most unsatisfactory feature of the old law. An amendment, effective May 6, 1935, substitutes for the old "equitable adjustment provision" a provision that, where the corporate activity or business transacted in the State and, in any case, where the tangible assets of the corporation are of nominal value or constitute a minor element of the business transacted in the State, the Tax Commission shall have authority to determine the proportion of entire net income taxable in the State, as a measure of the franchise tax, by the application of a new, arbitrary, statutory formula.

The legislature has selected two additional factors to be used in the statutory allocation along with the segregation of the enumerated classes of assets heretofore used as described under "Allocation," above. These additional factors are summarized below:

1. Gross sales or gross receipts. Parenthetically, it should be noted that the term "gross receipts" is not synonymous with gross income.
2. Gross expenses, limited to those expenses involved in service, operation and maintenance.

The allocating percentage is computed by taking the average of the three foregoing percentages, i. e., the two new factors plus the old factor. It is expressly set forth that the new provision does not apply to so-called investment trusts, corporate or noncorporate, whose principal business consists of holding, buying or selling for their own account, the securities of other corporations.

In providing this new formula, the legislature failed to recognize what is clear to everyone who has studied the

subject and that is, that there is no entirely accurate way of allocating income from a business transacted in more than one jurisdiction. The corporate activities of an enterprise in one jurisdiction contribute, directly or indirectly, to the resources of the business in every other jurisdiction. It is not possible to determine, except in a rough way, how much of the income may be reached for taxation by each jurisdiction.

Property within the jurisdiction is without doubt some test of the part of income that ought to be reached by taxation within the jurisdiction. On the other hand, certain expenses and disbursements within the jurisdiction are only a partial index of the total activities within the jurisdiction. Similarly, gross sales or gross receipts are to some extent a gauge of jurisdictional activities. There are many other tests with which accountants are familiar that tend to establish a rational relationship between results and operations. Some of these could be usefully employed to reach a rational allocation, but the legislature has not seen fit to adopt a permissive provision with respect to their use.

The statute is not clear as to what happens when the triangle-formula does not fit a case any better than the segregation ratio of assets. It may be that if one or two of the factors is entirely inapplicable, then the remaining factor or factors must be used. The new law, in a way, appears to follow the pattern applied to the Massachusetts corporation excise tax and the California franchise tax measured by net income.

Under the Massachusetts law, non-existing factors are eliminated from the averaging of percentages process. If, however, a factor exists, but not in the State, the numerator of the fraction for the factor is taken at zero and the fraction results in zero and none of this fraction of income is allocated to the State.

If the new provision is going to introduce further complications to confound the taxpayer, such as the foregoing which are not provided for in the statute, it is evident that the new remedy is merely another arbitrary method of allocation and a substitution of a new evil for an old one as far as the protesting taxpayer is concerned. The advantage to the State is that the new provision will be more serviceable to the Tax Commission in that it will supply the necessary color of authority to subdue the otherwise militant taxpayer. The new provision may not be as open to possible rejection by the courts as was the old, in view of the many decisions of the courts that if allocation of income on the whole is reasonable, it cannot be held to be bad because in some respects it is oppressive as to a particular corporation.

As an arbitrary method applied to a specific case, it may be a wide departure from that determination of income within the State which could be ascertained by any usual or special accounting methods reasonably applied to a given enterprise as a special case.

The legislature seems to have overlooked the possibility of an elastic statutory procedure, which would have ameliorated the oppressive features of the old "equitable adjustment provision." In such States as California and Massachusetts, the statute provides that the taxpayer may decline to accept the statutory method of alloca-

tion by giving due notice to the Commission of a proposal to use such other method as is fairly calculated to assign to the State the portion of net income reasonably attributable to business done within the State and to avoid subjecting the taxpayer to double taxation. Then, if the tax officials are expressly charged with the duty of determining the proper allocation of income, the corporation may expect to have its income allocated according to the statutory formula unless the officials in the exercise of a sound discretion are convinced that the taxpayer has submitted a method which reflects much more clearly just how much of its income is derived from business transacted in New York State.

Instalment Payments of Tax: For the tax year beginning November 1, 1936, and thereafter, the tax must be paid in instalments as follows: one half when filing the report; one half on or before January 1 of the year following the filing of the report upon which the tax is based, or within thirty days after the date of the assessment notice, if such date is subsequent to December 1 of the year for which the tax is assessed.

If the corporation is subject to the minimum tax of $25, this payment must accompany the return. If the total tax is to be more than $25 but not more than $50, the amount of $25 must accompany the return.

For the tax year beginning November 1, 1935, based upon the return filed in 1935, the tax is to be paid at one time instead of in instalments, and, as heretofore, based upon an assessment notice from the Commission, which will be payable not later than January 1, 1936, or within thirty days after the date of assessment notice if such date is after December 1, 1935.

Capital Gains and Losses: The Commission will not follow the Federal statutory rule which limits the deduction for capital losses over capital gains to $2,000, but will allow the actual amounts of gain or loss to be reflected in the corporation's income statement. In the preparation of the report on Form 3 IT, the reconciliation schedule of the Federal return should be inspected for any deductions due to any excess of capital losses over $2,000.

Payroll Tax Under Unemployment Insurance Law

The unemployment act, widespread in its scope and intricate in its scheme, blazes a trail in another new field of social legislation. It applies to all employers of four or more persons, excepting non-profit organizations, the State and its local subdivisions. The payroll tax is based on payments made to all employees, with the exception of farm laborers, spouse and minor children of employer, and those other than manual workers who receive more than $2,500 a year or more than $50 a week.

Records and Audit of Payrolls: Effective April 25, 1935, "every employer, including employers not subject to this Article, shall keep a true and accurate record of the number of his employees and the wages paid by him, and shall furnish to the (Industrial) Commissioner, upon demand, a sworn statement of the same. Such record shall be open to inspection at any time and as often as may be necessary to verify the number of employees and the amount of the payroll. Any employer who shall fail to keep such

record or who shall wilfully falsify any such record shall be guilty of a misdemeanor."

In determining employers subject to the assessment and related matters, the starting point is the payroll for 1935. The tax will, however, be payable for the first time in 1936 and will be applied to the payrolls of that year.

Rates of Tax: The rate of tax is 3 per cent of payroll, except for the years 1936 and 1937, when the rate will be 1 per cent and 2 per cent respectively. The first payment by the employer will be due beginning January 1, 1936, but collection will not start before March 1, 1936.

The Unemployment Fund created through contributions by employers, is the sole source of benefits. Delinquent tax contributions will be subject to interest at 6 per cent per annum. The rate of tax may be reduced after 1938 in the case of employers who have a good employment record upon some basis of an experience rating yet to be developed in the course of administration.

Employment: "Employment" means any hiring under a contract, express or implied, oral or written, and includes "all contracts entered into by helpers and assistants of employees, whether paid by employer or employee, if employed with the knowledge, actual or constructive, of the employer" in which either (1) all or the greater part of the work is to be performed within the State, or (2) the contract of employment is entered into within, and the work is in any part to be performed within the State. Farm labor, services rendered by a spouse or minor children of the employer or services performed for eleemosynary non-profit organizations are not included.

Benefits: Distributions will not be made until after January 1, 1938. They will be payable at the rate of 50 per cent of the employee's full time weekly wage with a minimum of $5 and a maximum of $15 per week and according to a ratio of one week of benefits for every 15 days of employment during the preceding 52 weeks. A three weeks' waiting period is provided, and in any 52 consecutive weeks the employee is limited to receive not more than 16 times the benefits for one week. If employment is lost through misconduct, strike or lockout, the waiting period is 10 weeks.

Administration: The Act is to be administered by the Industrial Commissioner with the aid of an advisory council composed of representatives of employers, employees and the general public. The manager of the employment office where the claim for benefits is filed will first pass upon the claim and an appeal will lie to an appeal board. Special provisions for part-time and seasonal workers are to be established.

Other State Taxes Continued

The existing stock transfer tax at the rate of 3 cents per share of par or no par stock sold for under $20 and 4 cents per share of par or no par stock sold for $20 or more, is continued for the period up to June 30, 1936.

The existing estate tax rates have also been extended to July 1, 1936, and the rate of gasoline tax has been increased from 3 cents to 4 cents per gallon for the period between April 1, 1935 and June 30, 1936.

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. & Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest, and to help in the solution of common problems.

Auditors' Reports

The auditor's client, because of his lack of technical knowledge of accounting or audit procedure, may have but little faculty for judging the effectiveness of the auditor's work while it is in progress. When, however, the auditor has completed his examination and submits his report, the client begins to form an opinion as to the probable effectiveness of the examination and of its value to him. This trite observation emphasizes the importance of an auditor having a full understanding of the essentials of an informative and helpful report.

When the accounts of a client are being audited year after year it may be difficult to avoid drifting into a stereotyped form of report for successive periods. Yet just this situation is the challenge to the wide-awake auditor to prepare a report in such a manner that, even though it may need to reiterate things already said in principle in the reports of previous years, it will, nevertheless, be couched in such language as to arouse the interest of the client anew.

It is seldom that at least one new idea cannot be introduced in a periodical audit report. It may be to emphasize some development during the year

that warrants special consideration by the client, or a recommendation for improvement in the accounting records or methods. On the other hand, it may take the form of a suggestion for some line of investigation or research by the client's staff to develop information which might open new fields of activity, or means of reducing costs of manufacture, selling, and administrative expenses, etc. Another source of helpful suggestion to a client may be with regard to income or other taxes which the business may be required to pay and which may not always have been handled most advantageously to the client's interest, or, in the case of affiliated companies, whether intercompany transactions are treated so as to obtain the maximum tax benefit that may properly be claimed when separate returns are filed by the companies of the group.

In the recently published Fifth Edition of Colonel Montgomery's *Auditing Theory and Practice,* the chapter on Auditors' Reports was carefully revised, and warrants careful study by each member of our organization. In order to encourage such study, a condensation of the chapter appears in this issue of the Journal. It is hoped that this will lead to the reading of the complete chapter in the book itself by every member of the staff who has not already studied it and absorbed its pungent suggestions for the improvement of auditors' reports.

The Journal Abroad

Although the L. R. B. & M. JOURNAL is published primarily for distribution among the members of our organization, we receive from time to time calls for copies of issues containing articles which in some way or other have come to the inquirer's attention. Requests have also been received from various sources, including a number of universities, asking that the JOURNAL be mailed regularly.

As a result of these requests over a period of sixteen years of publication, the JOURNAL has been sent to nearly all points of the globe. It is kept in bound form for reference purposes in some of the outstanding universities of the United States.

An idea of the various types of our readers may be gained from the following brief summary of some of the requests received in the last few years. One call came from Nueva Ecija, in far off Philippine Islands. Another came from Wellington, New Zealand.

A New York office client requested that we send copies of a particular issue to its branches in Paris and Hamburg. A student in a college at Seattle, Washington, asked for a special issue, as did also a professor of a college at Berkeley, California.

An accountant in Havana, Cuba, asked for a copy of the 35th Anniversary Number, and copies of other issues were requested by an accountant in Denver, Colorado, and an accounting firm in San Francisco, California.

An instructor in a college in Cebu, Philippine Islands, wrote for a copy of an issue which appeared to have been lost in the mails, so that he might keep his file complete.

A professor of accounting in a university in Milan, Italy, requested a copy of the issue containing an article on accounts of a cotton merchant, stating that he was deeply interested in that subject. Another professor at

Alessandria, Italy, asked that his name be placed on the mailing list.

The Far East sent some further calls, one from Manila, Philippine Islands, and the other from Tientsin, China.

From time to time requests for issues have been received from individuals holding responsible positions with Government agencies at Washington, D. C.

By far the greatest call for one number was in connection with the March, 1935, issue, which contained the articles on "Liabilities of Directors" and "Budgetary Control," and which issue, because of the present widespread interest in the subject of directors' liability, we made generally available to our clients. An officer of a corporation in the Middle West, which is not one of our clients, wrote for twenty copies, stating that he had already read the article on "Liabilities of Directors" to his executive committee but he wished to send a copy to each member of the board of directors.

A prominent lawyer in New York wrote Colonel Montgomery as follows:

> One of your clients sent me a copy of your last L. R. B. & M. Journal, and I read with extreme interest your personal article on the liability of directors.
>
> I wish to congratulate you on it; it is helpful to lawyers, and I wish all directors could have a chance to read it. Congratulations.

It is a satisfaction that although the Journal's primary mission is to serve our own organization, it also performs an occasional service outside the ranks of our staff.

Notes

Colonel Montgomery addressed the New York Credit Men's Association on May 7 on "What the Credit Man Needs Beyond a Balance Sheet," and conducted a discussion following his talk.

Mr. Marsh addressed the March meeting of the Indianapolis chapter of the National Association of Cost Accountants on the subject, "New Rulings in Connection with Back Taxes." He addressed the Louisville chapter at its March meeting on the subject, "Depreciation Under Treasury Decision 4422."

Mr. C. L. Queen addressed the San Francisco Chapter of the N. A. C. A. at its February meeting on his experience with relation to accounting, statistical, and analytical studies in the field of N. R. A. and A. A. A. canning control.

Mr. Roswell Magill, who is associated with Colonel Montgomery, is the author of an article "The Too Well Remembered Man," which appeared in the April issue of FORTUNE.

Mr. Staub was the session chairman of the April 12th evening meeting of the Four-State Conference of Certified Public Accountants attended by the state societies of Connecticut, New Jersey, New York, and Pennsylvania, held at Atlantic City. The principal speaker at that session was Carl H. Chatters, Executive Director of the Municipal Finance Officers' Association of United States and Canada. His topic was "Professional Accountants Can Aid Municipalities."

The following members of the staff of the New York office successfully passed the New York State C. P. A. examination recently held in New York: J. D. Hereford, Jr., H. C. Lang, S. F. Mirandy, W. R. Staub.

The fact that a man cannot be proficient in all lines probably accounts for the loss of the bowling match by our New York office to the West Hempstead Bowling u. Gesang Verein on April 5, 1935.

Mr. Bischoff, who brought the West Hempstead bowlers to New York from the wilds of Long Island for the match, and interviewed them afterward, stated that it was their consensus of opinion that the L. R. B. & M. team must be good accountants.

WHAT THINGS COST

Quotations are cash prices in primary markets as reported in New York Herald Tribune

The following table is of interest as showing the range of commodity prices over a period in which major changes in the price level occurred. In 1920 prices reached their maximum for the wartime era; these may be contrasted with the prices in 1913, a year of relative "normalcy" in the preceding economic era. In the current period the prices of some commodities have already recovered from depression lows sufficiently to bring them back to, or close to, their 1929 level.

Attention should be directed to the fact that during the years shown, other than 1935, the dollar was on the basis of $20.67 per ounce of gold, whereas now the price of gold is $35 per ounce. This factor needs to be considered in relation to those commodities, the prices of which are fixed in world markets rather than merely in the domestic market. Present-day restriction on production, for example, in the case of various agricultural products, is also to be borne in mind in comparing present prices with those of the pre-war period.

	April 30, 1935	*March 4, 1929*	*1920 Range*		*1913 Range*	
			High	*Low*	*High*	*Low*
FOODS—						
Wheat (No. 2 hard, N. Y.), bu	$ 1.23⅛	$ 1.39⅞	$ 3.50	$ 1.79	$ 1.16	$ .95¼
Corn (No. 2 yellow, N. Y.), bu	1.06	1.14½	2.31¾	.94½	.85½	.56
Oats (fancy clip white), bu	.65¾	.62	1.50½	.60	.50	.37
Flour (spring pat.), bbl.*	7.40	6.42½	16.25	9.00	4.90	4.30
Beef (family), bbl	21.50	26.50	28.00	20.00	7.35	5.30
Pork (mess), bbl	27.75	30.00	47.00	29.50	20.50	17.75
Sugar (granulated), lb	.0525	.049	.23	.08	.0495	.0413
Coffee (No. 7 Rio), lb	.07	.18⅛	.13¾	.06½	.13⅞	.08⅞
Butter (creamery, extras), lb	.29⅞	.51	.77	.51½	.38	.26¼
Eggs (fresh, first), doz	.26⅝	.45	.89	.42½	.60	.18
TEXTILES—						
Cotton (middling upland), lb	.122	.201	.43¾	.14½	.14½	.0413
Print cloth (38½ in. 64-60), yd.**	.06¼	.07⅝	.26	.07½	.05½	.04⅝
Silk (raw, gr. xx white 13-15), lb	1.62½	5.72½	....	....	....	....
Silk (raw, best extra white 13-15), lb***	1.42½	5.05	17.45	5.00	4.20	3.45
Wool (fine and med. stp. ter.), lb	.59	1.09	2.00	.80	.60	.47
METALS—						
Steel billets (Pittsburgh), ton	27.00	34.00	65.00	43.00	28.50	20.00
Iron (No. 2x fdry., Phila.), ton	20.26	21.26	53.50	33.00	18.50	15.00
Lead (spot), lb	.0375	.071	.09½	.04½	.04¾	.04
Copper (elec.), lb	.09	.19¼	.19½	.12½	.17¾	.14½
Tin (Straits), lb	.50⅞	.487½	.65¼	.32	.51	.36⅞
RUBBER, HIDES, ETC.—						
Rubber (rib-smoked sheets), lb	.11 9/16	.25¾	.54½	.15½	1.10	.76
Hides (calfskins, city), 9 to 12 lbs	2.40	2.95	10.50	2.10	2.70	2.50
Crude oil (Pennsylvania), bbl	2.35	4.10	6.10	5.00	2.50	2.05
Coal (furnace), ton	9.75	13.74	15.75	14.50	6.00	5.65

*Quotation for 1935 includes tax.
**Quotations for years previous to 1929 are for 38 in. 34x60. Quotation for 1935 includes tax.
***Quotations for years previous to 1929 are for No. 1 Sin, a grade slightly inferior to best extra white 13-15. The grading of silk was changed during 1928.

Lybrand, Ross Bros. & Montgomery

Offices

Cities	*Addresses*
New York:	Downtown, 90 Broad Street
	Uptown, 1 East 44th Street
Philadelphia	Packard Building
Chicago	231 South LaSalle Street
Boston	80 Federal Street
Newark	744 Broad Street
Baltimore	First National Bank Building
Washington	Investment Building
Pittsburgh	Union Bank Building
Detroit	Book Building
Cleveland	Midland Building
Cincinnati	Carew Tower
Louisville	Heyburn Building
Saint Louis	411 North Seventh Street
Rockford	321 West State Street
Atlanta	Healey Building
Dallas	First National Bank Building
Houston	Bankers Mortgage Building
San Francisco	2 Pine Street
Los Angeles	621 South Spring Street
Portland	Porter Building
Seattle	Skinner Building
	Europe
London, England	3 St. James's Square, S. W. 1
Paris, France	3 Rue des Italiens
Berlin, Germany	56 Unter den Linden